BILLING CODE 8070-01-P

FEDERAL HOUSING FINANCE AGENCY

[No. 2024-N-5]

Freddie Mac Proposed Purchase of Single-Family Closed-End Second Mortgages; Comment Request

AGENCY: Federal Housing Finance Agency.

ACTION: Notice of proposed Enterprise new product; request for comment.

SUMMARY: The Federal Housing Finance Agency (FHFA) invites comments on a proposal by the Federal Home Loan Mortgage Corporation (Freddie Mac) to purchase certain single-family closed-end second mortgages as a new product (proposed new product).

DATES: FHFA will accept written comments on the proposed new product on or before **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

ADDRESSES: You may submit your comments by electronic mail (E-mail) only on the proposed new product, identified by "Proposed Enterprise New Product; Comment Request 'Freddie Mac Single-Family Closed-End Second Mortgages,' (No. 2024-N-5)," by either of the following methods:

- *Agency website:* *www.fhfa.gov/open-for-comment-or-input*.
- *Email:* *RegComments@fhfa.gov*.

FHFA will post all public comments received without change, including any personal information you provide, such as your name, address, e-mail address, and telephone number, on the FHFA website at *http://www.fhfa.gov*. In addition, all comments received will be available for examination by the public through the electronic comment docket for this notice also located on the FHFA website.

FOR FURTHER INFORMATION CONTACT: Eric Bryant, Policy Analyst, Division of Housing Mission and Goals, (202) 253-4505, eric.bryant@fhfa.gov; William Merrill, Associate Director, Division of Housing Mission and Goals, (202) 649-3428, william.merrill@fhfa.gov; Lyn Abrams, Associate General Counsel, Office of General Counsel, (202) 649-3059, lyn.abrams@fhfa.gov; or Dinah Knight, Assistant General Counsel, Office of General Counsel, (202) 748-7801, dinah.knight@fhfa.gov, Federal Housing Finance Agency, 400 Seventh Street, SW, Washington, DC 20219. These are not toll-free numbers. For TTY/TRS users with hearing and speech disabilities, dial 711 and ask to be connected to any of the contact numbers above.

SUPPLEMENTARY INFORMATION:

I. Background

A. FHFA's Statutory and Regulatory Authority

FHFA oversees the government sponsored enterprises, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac and, together with Fannie Mae, the Enterprises), to ensure that they operate in a safe and sound manner, achieve the purposes of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended[1] (the Safety and Soundness Act), fulfill their statutory charters,[2] and comply with other applicable laws.[3]

---

[1] 12 U.S.C. 4501 *et seq.*
[2] 12 U.S.C. 1716 *et seq.* and 12 U.S.C. 1451 *et seq.*
[3] Since 2008, FHFA has also acted as conservator for each Enterprise.

In recognition of the significant impact that the activities of the Enterprises have on the U.S. housing finance system, market participants, and the broader economy, section 1321 of the Safety and Soundness Act requires the FHFA Director to review new Enterprise activities and to approve new Enterprise products before these activities and products are offered to the market.[4] Under the Safety and Soundness Act, for any new activity, an Enterprise must seek a determination from the Director as to whether the new activity is a new product that is subject to FHFA prior approval.[5] Before taking a decision on a new product proposal, the Safety and Soundness Act requires the Director to provide the public with notice and an opportunity to comment on the proposal and prescribes a 30-day public notice period.[6] The Safety and Soundness Act also specifies the standards that must be considered by the Director in acting on a new product proposal.[7] Those standards specifically require the Director to make a determination that the proposed new product is in the public interest.

FHFA implements these statutory requirements through its regulation on Prior Approval for Enterprise Products.[8] The regulation establishes a framework for identifying new activities and new products and a process for an Enterprise to provide FHFA with advance notice of a new activity and to request prior approval of a new product.[9] The regulation also describes the factors that the Director may consider when determining whether a proposed new product is in the public interest. Those factors fall into three broad categories: (1) the impact of the new product on the Enterprise's public

---

[4] *See generally*, 12 U.S.C. 4541.
[5] 12 U.S.C. 4541(e)(2).
[6] 12 U.S.C. 4541(c).
[7] 12 U.S.C. 4541(b).
[8] 12 CFR part 1253.
[9] 12 CFR 1253.3 and 1253.4.

mission; (2) the impact of the new product on the stability of mortgage finance or financial system; and (3) the impact of the new product on the competitiveness of the housing finance market.[10] In addition to the enumerated public interest factors, the Director retains the discretion to seek public comment on any other appropriate factor.

FHFA has determined that Freddie Mac's proposed purchase of closed-end second mortgage loans is a new product for Freddie Mac that merits public notice and comment about whether it is in the public interest.[11] In turn, Freddie Mac has requested FHFA's approval to proceed with the proposed new product. Consistent with statutory and regulatory requirements, FHFA is seeking public comment on the proposed new product, including on the public interest factors set forth in the regulation and additional factors which the Director has determined to be appropriate. The Director will consider all public comments received by the closing date of the comment period to inform the determination as to whether the proposed new product is in the public interest.[12]

B. Freddie Mac's Charter Act

One element of assessing the public interest is examining the degree to which the new product might advance any of the purposes of the Federal Home Loan Mortgage Corporation Act (charter act).[13] Congress created Freddie Mac to serve four public purposes: "(1) provide stability in the secondary market for residential mortgages; (2) respond appropriately to the private capital market; (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return

[10] 12 CFR 1253.4(b) and 1253.6(e).
[11] *See*, 12 CFR 1253.3(a)(1).
[12] 12 CFR 1253.6(b)(3).
[13] 12 U.S.C. 1451 *et seq*.

that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and (4) promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."[14]

Freddie Mac must operate within the confines of the powers expressly granted to it by Congress under its charter act, and the exercise of those powers must fulfill one or more of the statutory purposes that Congress articulated in the charter act. Section 305(a)(4) of the charter act specifically authorizes Freddie Mac to purchase, service, sell, lend on the security of and deal with subordinate mortgages secured by a single-family or multifamily property, provided certain conditions are met.[15]

II. The Proposed New Product

A. Objective

In the current housing market, marked by higher mortgage rates, low housing supply, and continued year-over-year house price appreciation, existing borrowers face limited options to access the equity in their primary residences. For the many homeowners who purchased or refinanced their homes during a period of lower mortgage rates, a traditional cash-out refinance today may pose a significant financial burden, as it requires a refinancing of the entire outstanding loan balance at a new, and likely much higher, interest rate. Homeowners may also use second mortgages to access the equity in their homes. For a second mortgage, only the smaller, second mortgage would be subject

[14] 12 U.S.C. 1451 note.
[15] 12 U.S.C. 1454(a)(4).

to the current market rate, as the original terms of the first mortgage would remain intact. Moreover, second mortgages are typically offered at a lower interest rate than some financing alternatives such as consumer or personal loans.

Freddie Mac proposes to purchase certain closed-end second mortgage loans from primary market lenders who are approved to sell mortgage loans to Freddie Mac (Sellers). In a closed-end second mortgage loan, the borrower's funds are fully disbursed when the loan closes, the borrower repays over a set time schedule, and the mortgage is recorded in a junior lien position in the land records. Freddie Mac has indicated that the primary goal of this proposed new product is to provide borrowers a lower cost alternative to a cash-out refinance in higher interest rate environments. Purchase parameters would seek to minimize credit risk to Freddie Mac while balancing with potential cost saving to existing homeowners.

B. Key Offering Parameters

The following tables contain Freddie Mac's proposed parameters which help describe the proposed new product. There are two tables indicating the various parameters; one table focuses on general eligibility while the other table focuses on servicing and underwriting. The requirement field in the tables below represents the important criteria and features of the proposed new product. The observation field indicates how the specific requirements would assist Freddie Mac in managing the proposed new product to have a positive effect in the relevant marketplace. These items are potential considerations to minimize risk and assist with an efficient operational process.

TABLE 1– GENERAL ELIGIBILITY

TERMS	REQUIREMENT	OBSERVATION
Seller Participation	Seller must be an approved and active Seller/Servicer to Freddie Mac.	Ability to meet the financial and counterparty standards to sell loans to Freddie Mac.
Second Mortgage	Freddie Mac will only purchase a second mortgage if it currently owns the first mortgage.	Assist with servicing and risk oversight.
Restricted Products	Certain second mortgages would be ineligible such as land trusts and co-operative share mortgages.	Minimize additional layers of risk due to complexity and terms.
Evaluation Period	Limitations on the number and aggregate unpaid principal balance of second mortgage purchases for an initial period.	Provide an opportunity to manage risk and create the infrastructure to support possible future growth.
Loan Terms	Fixed-rate fully amortizing loan up to a 20-year term on borrower's primary residence.	Fixed and stable payment for the borrower.
Loan Acquisition: Commitments & Delivery	Second mortgages would initially be delivered through the Cash Window.	Help manage the market risk in the pipeline.
Pricing	Freddie Mac would initially provide "spot bids" rather than forward prices to its Sellers.	Help achieve appropriate risk vs. return ratios.
Securitization	Loans would remain in portfolio for approximately six to nine months until the creation of second mortgage non-TBA guaranteed securities and for systems implementation.	Allow for Credit Risk Transfer opportunities that would be evaluated in subsequent phases.

TABLE 2–SERVICING & UNDERWRITING ELIGIBILITY

TERMS	REQUIREMENT	OBSERVATION
Loan Servicing	Overall servicing for second mortgages would be similar to servicing requirements for current first mortgages.	Consistency with servicing and risk oversight.
Loss Mitigation	Overall loss mitigation servicing for second mortgages would be comparable to current servicing requirements for delinquent first mortgages. Specific loss	Freddie Mac could holistically review the performance of both loans.

	mitigation solutions for all foreclosure activities on the closed-end second mortgage would require Freddie Mac approval.	
Manual Underwriting	Initially, the Seller would manually underwrite the mortgage.	Interim approach until automated underwriting is available.
Maximum Total Loan-to-Value (TLTV) ratio	<= 80%, Manufactured Home <= 65%, Not to exceed the maximum LTV/TLTV for cash-out refinance mortgage.	Helps maintain acceptable risk levels.
Payoffs	If the first mortgage is refinanced the second mortgage must be paid in full with the first mortgage unless prohibited by law.	Avoids Freddie Mac master servicing only second mortgages.
Representation and Warranty (R&W) Framework	R&W framework for the second mortgage and the first mortgage, if applicable, would be applied independently.	Encourages independent and holistic quality control measures.

C. *Potential Impact*

Freddie Mac's proposed new product may impact various stakeholders such as borrowers, Freddie Mac, and the relevant market participants.

Potential Borrower Benefit

In the current mortgage interest rate environment, a closed-end second mortgage may provide a more affordable option to homeowners than obtaining a new cash-out refinance or leveraging other consumer debt products. A significant portion of borrowers have low interest rate first mortgages, and the proposal would allow those homeowners to retain this beneficial interest rate on the first mortgage and avoid resetting to a higher rate through a cash-out refinance.[16]

The following table is an illustrative example of a borrower having two distinct choices to access the $30,000 equity available in their current home. In Option A, the closed-end second mortgage, the borrower retains their existing three percent fixed rate mortgage, which has an initial unpaid principal balance (UPB) of $150,000 and current UPB of $120,000. The borrower obtains a second mortgage for $30,000 at a fixed interest rate of 9.5 percent for a 20-year term.

In Option B, the cash-out refinance, the borrower obtains a cash-out refinance at a hypothetical mortgage interest rate of 7.5 percent. The borrower refinances into a new first mortgage with a new principal balance of $150,000 and pays off the original first mortgage with an outstanding UPB of $120,000, retaining $30,000 to use for their personal benefit.

TABLE 3–ILLUSTRATIVE COMPARISON OF CASH-OUT REFINANCE TO A SECOND MORTGAGE USING FREDDIE MAC PROVIDED INFORMATION

	Option A	**Option B**
Scenario	• Maintain First Mortgage • Origination UPB $150,000 • Current First Mortgage UPB $120,000 • Obtain a Second Mortgage for $30,000	• Cash-out refinance for $150,000 • Payoff Existing First Mortgage for $120,000 • Borrower Receives $30,000 cash
First Mortgage <u>Initial</u> terms	3% fixed rate 360-month term Originated ~ 8.5 years ago	7.5%[17] fixed rate 360-month term Originated in 2024
<u>Current</u> First Mortgage	$120,000	$150,000

[16] U.S. Economic, Housing and Mortgage Market Outlook, Freddie Mac (December 2023), p. 4, *available at* https://www.freddiemac.com/research/pdf/Freddie_Mac_Outlook_December_2023.pdf.
[17] Refinance Rates Slide Down Again: Mortgage Refinance Rates for March 18, 2024 - CNET Money, *available at* https://www.cnet.com/personal-finance/mortgages/mortgage-interest-rates-today/. "Refinance rates are currently between 6.5% and 7.5%, but your personal interest rate will depend on your credit history, financial profile and application."

UPB and terms	258 remaining months	360 remaining months
First Mortgage Monthly Payment	$632.41	$1,048.82
Second Mortgage UPB and terms	$30,000 9.5% fixed rate[18] 240 payments	N/A
Second Mortgage Monthly Payment	$279.64	N/A
Total First and Second Mortgage Monthly Payment (if any) Amounts	$912.05	$1,048.82
Total First and Second Mortgage Interest Paid (if any) by Borrower	$114,779[19]	$227,576[20]

Table 3 above illustrates the potential borrower's savings between the two options for the total monthly loan payment amounts, Option A (closed-end second mortgage) [$632.41 + $279.64 = $912.05]; Option B (cash-out refinance) [$1048.82]. In this scenario the borrower will save $136.77 per month by choosing Option A, the closed-end second mortgage. Table 3 also illustrates the total interest savings from a closed-end second mortgage. It specifically highlights the lower costs of the closed-end second mortgage (Option A) [$77,666 first mortgage + $37,113 second mortgage = $114,779 total interest paid] versus the cash-out refinance (Option B) [$227,576 total interest paid]. Thus, the closed-end second mortgage saves the borrower $112,797 in total interest paid compared to the cash-out refinance. The savings to the borrower could vary by the interest rates and the loan terms.

Borrowers may possibly benefit from lower costs if more lenders offer closed-end

[18] Current Home Equity Interest Rates | Bankrate, the home equity loan average rate range is 8.41% - 9.49%, *available at* https://www.bankrate.com/home-equity/current-interest-rates/?zipCode=20024.
[19] This amount reflects life of loan interest costs on both mortgages.
[20] This amount does not include mortgage interest already paid on the prior mortgage.

second mortgages. If there is more competition among second mortgage lenders, this may provide borrowers with more lender choices and better pricing to further reduce their costs.

Potential Enterprise Impact

Freddie Mac believes the proposed new product may advance its charter act purposes by providing liquidity and stability in the secondary mortgage market. Freddie Mac also believes it could provide a foundation for more consistent liquidity in the secondary mortgage market because of its credit guarantee and experience securitizing mortgage loans. Freddie Mac believes that the shorter duration of the second mortgage term as described in table 1, relative to a typical 30-year cash-out refinance, would lower Freddie Mac's credit risk relative to a cash-out refinance while providing borrowers with significant cost savings due to the interest savings on a shorter repayment schedule. Finally, Freddie Mac would specifically review and develop compliance and technology risk mitigation strategies for this proposed new product.

Since Freddie Mac would only purchase a closed-end second mortgage if it has purchased the first mortgage, Freddie Mac would have insight into the performance of both loans, enabling better risk management by providing consistent servicing support for both mortgages. Moreover, loss mitigation activities for closed-end second mortgages would be similar to Freddie Mac’s current solutions available for first mortgages. Certain loss mitigation solutions or proceeding with foreclosure on second mortgages would be decided by Freddie Mac, not the servicer. The borrower’s lower cost of credit and the servicer’s holistic approach should provide more sustainability and thus the potential for lower credit losses for Freddie Mac.

Potential Market and Seller Impacts

Financial institutions who choose to originate and/or buy closed-end second mortgages could securitize the loans or hold them on their balance sheet. Freddie Mac's involvement could provide participating Sellers with additional liquidity which could be beneficial in creating lending opportunities for more borrowers. Sellers would have an additional secondary market option to consider for obtaining their most favorable execution terms.

Sellers targeted for this proposed new product would be all lenders that are currently offering closed-end second mortgages or plan to offer such mortgages in the near term. Freddie Mac expects to be able to provide Sellers with pricing that would enable them to offer rates competitive with current market rates for closed-end second mortgages.

Current mortgage-backed securities (MBS) investors may experience slower pre-payment speeds if borrowers decided against a cash-out refinance. The retention of the existing mortgage avoids a payoff transaction to the MBS. This could be beneficial to investors by enabling them to realize a more predictable and consistent rate of return.

The proposed new product may provide data and process standardization to drive operational efficiency and assist with servicing the loans. Increasing secondary market transactions across many lenders may improve operational processes and data standards. Freddie Mac's ownership of both loans reduces the challenges of obtaining concurrence for loss mitigation solutions on the closed-end second mortgage and may assist with holistic borrower retention activities including loan modifications.

III. Request for Comments

FHFA requests comments on the questions below. Commenters do not need to answer each question. Please identify the question answered by the number assigned below.

1. To what degree might the proposed new product advance any of the purposes set forth in Freddie Mac's charter act (*see* section I.B above)?

2. To what degree might the proposed new product advance Freddie Mac's Duty to Serve Underserved Markets activities[21] and support Freddie Mac in meeting its housing goals[22]?

3. To what degree might the proposed new product already be supplied by other market participants?

4. To what degree might the proposed new product promote or lessen competition in the marketplace?

5. To what degree might the proposed new product overcome natural market barriers or inefficiencies?

6. To what degree might the proposed new product raise or mitigate risks to the mortgage finance or financial system?

7. To what degree might the proposed new product further fair housing and fair lending?

8. To what degree might borrowers benefit from or be adversely affected by

---

[21] Under the Safety and Soundness Act, the Enterprises have a statutory duty to serve three specified underserved markets—manufactured housing, affordable housing preservation, and rural housing—by increasing the liquidity for mortgage investments and improving the distribution of investment capital available for residential financing for very low-, low-, and moderate-income families in those markets. 12 U.S.C. 4565; 12 CFR part 1282.

[22] As required by the Safety and Soundness Act, the Director establishes annual housing goals with respect to mortgage purchases by the Enterprises. 12 U.S.C. 4561, 12 CFR part 1282. Purchases of subordinate lien mortgages, including the proposed new product, would not be treated as mortgage purchases for purposes of Freddie Mac's housing goals. 12 CFR 1282.16(b)(10).

the proposed new product?

9. Are there any other factors that the Director should take into consideration concerning the proposed new product?

/s/
Sandra L. Thompson,
Director,
Federal Housing Finance Agency.

4/16/2024
Date